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Early Retirement Incentive Plans and the Age Discrimination in Employment Act

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I. Introduction

Early retirement incentive plans (ERIP) "seek to give incentives to older employees to retire before conventional retirement age. The purpose of these programs is to cut back on salaries and benefits to make way for younger workers."[1] While some ERIPs might constitute a prohibited act under the Age Discrimination in Employment Act (ADEA), the statute provides an affirmative defense for employers who can prove that the plan is voluntary and "consistent with the purposes" of the Act.[2]

Some commentators have suggested that one way to encourage employers to establish bona fide phased retirement programs within their qualified pension plans is to craft an exemption for phased retirement programs from age discrimination claims that is similar to the ERIP exemption.[3] To facilitate a discussion of that idea, this memo provides an overview of the statutory exemption for early retirement incentive plans under ADEA.

II. The ERIP Exception in ADEA

A. Statutory Requirement and Legislative History

The exemption for ERIPs was added to ADEA in 1990 under the Older Workers' Benefit Protection Act (OWBPA). Although employers had implemented early retirement incentive plans prior to 1990, OWBPA clarified what practices would meet the ADEA requirements. Specifically:

> It shall not be unlawful for an employer, employment agency or labor organization. . .to observe the terms of a bona fide employee benefit plan . . . that is a voluntary early retirement incentive plan consistent with the . . . purposes of [ADEA].
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> 29 U.S.C. § 623(f)(2)(B)(ii).

OWBPA was enacted to overturn the Supreme Court's decision in Public Employees Retirement System of Ohio v. Betts, 492 U.S. 158 (1989). In Betts, the Court held that "Congress intended to exempt employee benefit plans from

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[1] Tanick, Marshall "Commentary: Recent ruling reflects rigid retirement risk, Daily Record and the Kansas City Daily News-Press, Feb. 9, 2006 available at http://findarticles.com/p/articles/mi_qn4181/is_20060209/ai_n16065298.

[2] 29 U.S.C. § 623(f)(2)(B)(ii).

[3] See Penner, R., Perun, P. and Steuerle, E., "Legal and Institutional Impediments to Partial Retirement and Part-Time Work by Older Workers" (2004) available at http://www.urban.org/UploadedPDF/410587_SloanFinal.pdf. A brief description of the report is available at http://www.urban.org/publications/410587.html.

the coverage of [ADEA] except to the extent plans were used as a subterfuge for age discrimination in other aspects of the employment relation." Id. at 180. The Court also explicitly rejected the argument that the only way a discriminatory benefit plan would not be considered a subterfuge under the ADEA would be if it met the "equal cost or equal benefit" standard articulated by the EEOC in its regulations. Id. at 172.

In response, OWBPA made clear that, consistent with the statute's original purpose of eliminating arbitrary age discrimination in all aspects of the workplace, ADEA applies to all employee benefit plans, including early retirement incentive plans.[4] The statute does, however, provide two safe harbors – a general one for employee benefits plans and one specific to ERIPs. An employee benefit plan is valid under ADEA if "the actual amount of payment made or cost incurred on behalf of an older worker is no less than that made or incurred on behalf of a younger worker." 29 U.S.C. § 623(f)(2)(B)(i). As noted above, early retirement incentive plans are valid under ADEA if they are voluntary and "consistent with the purposes" of the statute. 29 U.S.C. § 623(f)(2)(B)(ii).[5]

The early retirement exemption apparently was added to OWBPA after hearings in the Senate and House, in which the EEOC testified that there were questions regarding the legal standards for evaluating claims of discrimination under early retirement incentive plans.[6] The legislative history explains:

> At both House and Senate hearings, the bill was endorsed by the Equal Employment Opportunity Commission, with one caveat: we were asked to clarify that voluntary early retirement incentive plans did not necessarily have to meet the equal benefit or equal cost rule, but rather that they should be lawful as long as they furthered the purposes of the ADEA. We agreed to their request.[7]

In the section discussing the ERIP exemption, the Senate Report accompanying the OWBPA explains that "[i]n general, early retirement incentive plans may be

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[4] See S. Rep. No. 101-263, 1990 U.S.C.C.A.N. 1509, 1521-1522.

[5] The OWBPA bill originally exempted ERIPs that "further the purposes" of ADEA. The language was changed to "consistent with the purposes" in response to requests from the Republican Administration and business groups. See 136 Cong. Rec. S 13250 (Statement of Senator Metzenbaum) ("4(f)(2)(B)(ii) has been changed to allow an employer to offer any early retirement incentive plan that is consistent with the purposes of the ADEA. This change, suggested by the White House, was made because employers suggested to us that it would be difficult for an employer to show that an early retirement incentive plan furthers the purposes of the ADEA, as S. 1511 currently requires.")

[6] See id. at 1532 (citing Older Workers' Benefit Protection Act, S. Hrg. 101-308, 101st Cong. 1st Sess., 55, 60 (1989))(hereinafter *Senate Hearing on Older Worker Benefit Protection Act*); see also *Senate Hearing on Older Workers' Benefit Protection Act* at 427.

[7] 136 Cong. Rec. H 8616 (Statement of Senator Clay). The language in the bill had already been changed to "consistent with the purposes" of the ADEA, but the statement erroneously referred to the earlier formulation of the language.

considered lawful provided they are truly voluntary, are made available for a reasonable period of time, and do not result in arbitrary age discrimination."[8] The report further explains that "a wide variety of early retirement incentive plans may help employers and workers meet problems arising from the impact of age on employment, or promote the employment or retention of older workers, while at the same time prohibiting arbitrary age discrimination in employee benefits."[9] The report lists examples of early retirement incentives that lawmakers believed were valid under the OWPBA amendments, including "early retirement incentives that provide a flat dollar amount (e.g., $20,000), service-based benefits (e.g., $1,000 multiplied by the number of years of service), or a percentage of salary," as well as incentives that provide flat dollar increases in pension benefits (e.g. $200 per month), percentage increases (e.g. 20%), or that impute years of service and/or age."[10]

The report, cautions, however, that:

> Early retirement incentive plans that deny or reduce benefits to older workers while continuing to make them available to younger workers may encourage premature departure from employment by older workers. This not only conflicts with the purpose of eliminating age discrimination in employee benefits; it also frustrates (rather than promotes) the employment of older persons. . . .[11]

The report emphasizes that lawmakers "recognized that employees may welcome the opportunity to participate in such programs." It makes clear that while lawmakers sought to ensure that ERIPs not discriminate arbitrarily on the basis of age, they did "not intend to deprive employees of [early retirement] opportunities or to deny employers the flexibility to offer such programs rather than resorting to involuntary layoffs."[12]

With regard to what an employer would have to prove in order to demonstrate that a plan was "consistent with the purposes" of the Act, Representative Clay provided additional guidance:

> The phrase 'purposes of the Act' has been used as a standard in the ADEA for over 20 years, and the common approach has been to consider only the purpose or purposes that are relevant to the issue at hand. The bill endorses that approach. An early retirement incentive plan or a feature of the plan need not be shown to be consistent with every purpose of the ADEA in order to be found lawful. The one purpose that is always

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[8] S. Rep. No. 101-263, 1990 U.S.C.C.A.N. 1509, 1533.
[9] Id.
[10] Id.
[11] Id.
[12] Id. at 1533-1534.

> relevant, however, is 'to prohibit arbitrary age discrimination in employment.' The other two purposes ('to promote the employment of older persons based on their ability rather than age' and 'to help employers and workers find ways of meeting problems arising from the impact of age on employment') may be relevant on a case-by-case basis. If the plan or a feature of the plan is challenged, however, the employer must prove that the plan or feature is consistent with every purpose that is relevant.[13]

III. Judicial Interpretations

A. Overview

As noted, the statutory exemption for ERIPs provides the following:

> "It shall not be unlawful for an employer, employment agency or labor organization. . .to observe the terms of a bona fide employee benefit plan . . . that is a voluntary early retirement incentive plan consistent with the purposes of . . .[ADEA]". 29 U.S.C. § 623(f)(2)(B)(ii).

This exemption is an affirmative defense. Jankovitz v. Des Moines Indep. Cmty Schools, 421 F.3d 649, 654 (8th Cir. 2005). Thus, when a plaintiff challenges an ERIP under the ADEA, courts must first consider whether the plaintiff has set forth a prima facie case of disparate treatment or disparate impact discrimination.[14] Lyons v. Ohio Educ. Assoc. and Professional Staff Union, 53 F.3d 135, 137 (3d Cir. 1995). If a plaintiff cannot meet this initial burden, the court need not analyze whether the ERIP meets the exemption, because the ERIP is not discriminatory under the general provisions of ADEA.

If a plaintiff is able to make out a prima facie case of age discrimination with regard to an ERIP, the ERIP exception becomes relevant and "the defendant bears the burden of establishing that the early retirement incentive plan is

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[13] 136 Cong. Rec. H. 8616 (Statement of Sen. Clay).

[14] It is unclear what the impact of the Supreme Court's decision in Smith v. City of Jackson, 544 U.S. 228 (2005) (hereinafter City of Jackson) will have on a plaintiff challenging an ERIP under a disparate impact theory. In City of Jackson, the Supreme Court held that in an ADEA disparate impact claim, a plaintiff must point to a specific, age neutral employment practice and show that this specific practice has a disparate impact on the protected group (i.e. employees over 40). City of Jackson, 544 U.S. 228 at 242. However, even if the plaintiff can show that the employment practice had a disparate impact on the protected group, liability ultimately is precluded "if the adverse impact was attributable to a nonage factor that was reasonable." Id. at 239. In one of the few cases after City of Jackson challenging an ERIP under a disparate impact claim, the court found that even if there was a disparate impact on a subgroup of the protected group, the impact was attributable to date of hire or years of service, both of which are reasonable nonage factors. See, Myers v. Delaware County Cmty Coll., Civil Action No. -5-5855, 2007 U.S. Dist. LEXIS 16940, **29-20, 34 (E.D. Penn. Mar. 9, 2007)

voluntary and comports with the purposes of the ADEA." Auerbach, v. Board of Educ. of the Harborfields Central School Dist., 136 F.3d 104, 112 (2d Cir. 1998).

In determining whether an ERIP complies with ADEA's requirements, courts have held, post-OWBPA, that an ERIP must satisfy the following criteria:

- Differences in benefits may not be based on the age when an individual retires, but may differ based on factors other than age, such as years of service, date of hire, or age at date of hire;[15]
- An ERIP must be voluntary;
- ERIP benefits may not be decreased based on increasing age; and
- An ERIP may not utilize an upper age limit or an age-based window for eligibility.

The following sections discuss how courts have analyzed ERIPs under ADEA, post-OWBPA. The first section discusses cases in which the courts have evaluated whether the ERIP complies with ADEA's general provisions. The second section discusses cases where, because courts have determined that the plaintiffs established prima facie cases of discrimination, the courts then analyzed the validity of the plans under the ERIP exemption.

B. ERIPs and ADEA's General Provisions

1. ERIP Plan Designs with Differences in Benefits Based on Factors Other than Age Do Not Violate ADEA's General Provisions

In at least two cases considering the validity of an ERIP, courts have held that while differences in benefits may not be based on the age when an individual retires, a plaintiff cannot establish a prima facie case of age discrimination where the differences in ERIP benefits are based on factors other than age, such as years of service, date of hire, or age at date of hire.

For example, in Lyon, the Sixth Circuit upheld an ERIP where the disparity in benefits was based on years of service and age at the time of hire, because, the court determined, such factors are not proxies for age. Specifically, the court considered the validity of an imputation of service clause in which early retirement benefits were "at least equal to the same percent of salary that the participant would have received if the participant had retired on the normal retirement date."[16] Id. at 137. The court concluded that even though the clause

[15] Date of hire and years of service under a pension or retirement plan may not always be the same for various reasons -- such as an individual not immediately participating in the plan, experiencing a break in service, or in limited circumstances having prior employment imputed.

[16] The plan design provided for early retirement upon the earlier of the completion of twenty years of service or the attainment of age 60 with five years of service. Normal retirement was the earlier of age 62 or 32 years of service. Thus, for example, under the service imputation clause,

resulted in younger employees who took early retirement receiving greater pension amounts than older employees who retired with the same length of service, there was no evidence of discriminatory motive or intent. Rather, "any disparity merely reflects the actuarial reality that employees who start work at an early age accumulate more years of service in reaching the normal [retirement] age of 62." Id. at 140. Because the court found that the plaintiffs could not establish a prima facie case of discrimination, it did not consider whether the plan satisfied the requirements of the ERIP exemption in § 623(f)(2)(B)(ii). Lyon, 53 F.3d at 137.

Similarly, in Myers v. Delaware County Cmty Coll., Civil Action No. -5-5855, 2007 U.S. Dist. LEXIS 16940 (E.D. Penn. Mar. 9, 2007), the court found that an ERIP that based eligibility for and the amount of benefits on years of service did not violate the ADEA under either a disparate treatment or disparate impact analysis. The court concluded that even though early retirement benefits did not become available until an employee attained 30 years of service, and ceased to be available if an employee did not retire before attaining 36 years of service, the eligibility to elect benefits was independent of age. Id. at **19-20, 29-30. In addition, the court found that the practice of crediting service with prior employers for eligibility purposes also did not violate ADEA because the provision applied to all employees regardless of their age. Id. at **24,26, 34. Because the plaintiffs failed to establish a prima facie case of discrimination, the court did not analyze whether the plan satisfied the requirements of the ERIP exemption in §623(f)(2)(B)(ii).

2. ERIP Designs that Include an Upper Age Limit Violate ADEA's General Provisions

In Solon v. Gary Community School Corporation, 180 F.3d 844 (7th Cir. 1999), the Seventh Circuit struck down an ERIP with an age-based window in which those retiring at age 58 would have received four years of incentive payments, those retiring at 60 only two years, and those retiring at 62 or later, nothing. As the court explained, "[t]hose employees who elect to retire at 62 or later are put at a disadvantage for not retiring when they were 58 to 61, no matter how "early" their later separation may be in terms of their length of service or previous retirement plans." Id. at 852. "In this respect, employees who retire at a younger age are treated more favorably than those who retire later, based not on years of service or some other nondiscriminatory factor, but solely on their age at retirement." Id. at 853.

The Seventh Circuit analyzed the case under a disparate treatment analysis and did not go on to analyze whether the plan met the ERIP exemption because the

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an employee who took early retirement at age 52 would have received ten years of imputed service, whereas an employee who took early retirement at 60 would receive only 2 years of imputed service.

district court found that the defendant had waived its affirmative defense and the defendant did not raise the defense on appeal. Id. at 851

C. ERIP Exemption

1. Employee's Participation in an ERIP Must be Voluntary

If a plaintiff does successfully establish a prima facie case of discrimination, the defendant then bears the burden of establishing that the ERIP satisfies the ADEA exemption set forth in §623(f)(2)(B)(ii). Auerbach,136 F.3d at 112.[17] In other words, the defendant must prove that the plan is both voluntary and consistent with the purposes of ADEA. Id.

In order for an ERIP to be voluntary, an employee must be provided an uncoerced, free choice in which the employee:

- is given a full and accurate description of the plan so that the employee can make an informed decision whether to participate in the plan; and
- is given a reasonable amount of time to consider whether to participate in the plan. Auerbach, 136 F.3d at 113.

In other words, "to determine whether a retirement plan is voluntary, a court must consider whether, under the circumstances, a reasonable person would have concluded that there was no choice but to accept the offer." Id. (citing Paolillo v. Dresser Indus., Inc., 821 F.2d 81, 84 (2d Cir.1987) (giving employees only one weekend to accept early retirement raises question whether acceptance of plan is voluntary)).

In Auerbach, the Second Circuit considered the validity of an ERIP in which, to be eligible for early retirement benefits, a teacher was required to actually retire in the year in which the teacher first met the eligibility requirements, which was at least age 55 with 20 years of service. Because the plan in Auerbach did not require any teacher to accept the plan, provided accurate information to potential plan participants, and gave teachers approximately four months to avail themselves of the plan, the court held that the plan was in fact voluntary. Id. at 113.

[17] In Auerbach, the court concluded that plaintiffs had established a prima facie case in challenging the ERIP plan design where the ERIP provided window benefits that had to be elected in the year in which an employee met both the age and service requirements. The court found that the fact that some of the plaintiffs had reached the minimum age, but had not actually elected the ERIP benefits was a denial based on age because such individuals were forever barred from electing the ERIP benefits based solely on age. Auerbach, 136 F.3d at 112.

2. An ERIP Must be Consistent with the Purposes of ADEA

In addition to being voluntary, a plan must also be "consistent with the purposes of the Act" in order to qualify for the ERIP exemption. Congress articulated the following purposes in enacting ADEA:

- "to promote employment of older persons based on their ability rather than age;
- to prohibit arbitrary age discrimination in employment; and
- to help employers and workers find ways of meeting problems arising from the impact of age on employment."[18]

In determining whether a plan is consistent with these purposes – particularly whether the plan discriminates arbitrarily on the basis of age -- courts have looked to the statute's legislative history. As discussed above, Congress provided a series of examples of ERIPs that would and would not, in its opinion, be "consistent with the purposes" of the ADEA. For example, the legislative history suggests that ERIPs that deny or reduce benefits to older workers while continuing to make them available to younger workers perpetuates, rather than reduces, arbitrary age-based discrimination. S. Rep. No. 101-263, at 28, 1990 U.S.C.C.A.N. 1509, 1533. On the other hand, the legislative history suggests that time-related windows during which employees, upon attaining a specified age, are offered special incentives to retire, such as flat dollar amounts and/or service based benefits, are consistent with the purposes of the statute, in that they "may help employers and workers meet problems arising from the impact of age on employment." Id. Based on this legislative history, courts have held that, even under the ERIP exemption, ERIP benefits may not be decreased based on increasing age, and ERIPs may not utilize an upper age limit or an age-based window for eligibility.

a. *Benefits May Not be Decreased Based on Increasing Age*

"An early retirement incentive plan that withholds or reduces benefits to older retiree plan participants while continuing to make them available to younger retiree plan participants so as to encourage premature departure from employment by older workers conflicts with the ADEA's stated purpose to prohibit arbitrary age discrimination in employment." Auerbach, 136 F.3d at 114 (citations omitted). Thus, for example, in Auerbach, the Court upheld the plan in question because it did not reduce benefits to older participants, but rather, provided a time-related window in which all employees who reached a certain age and had worked for a specified number of years could avail themselves of the early retirement option. Id. The court noted that even though an individual was precluded from receiving the early retirement benefit at a later date, this was not inconsistent with ADEA because the "loss" of plan benefits was not based on

[18] 29 U.S.C. 621(b).

age, but rather, on the individual's decision not to elect such benefits when eligible. Id.

Conversely, in O'Brien v. Bd. Of Educ. of Deer Park Union Free School Dist., 92 F. Supp. 2d 100 (E.D.N.Y. 2000), the court struck down an ERIP in which the amount of early retirement benefits for accumulated sick leave was reduced from 100% in the first year of eligibility to 80%, 75% and 70% during the second, third and fourth years of eligibility, respectively. The court held that because the ERIP provided diminished benefits as the age of the participants increased, the plan arbitrarily discriminated on the basis of age and therefore conflicted with the purposes of the ADEA. Id. at 119.

b. *ERIPs May Not Utilize an Upper Age Limit or an Age-Based Window for Eligibility*

In determining an ERIP's validity under ADEA, courts also have struck down ERIPs that utilize an upper age limit or age-based window for eligibility. For example, the Eighth Circuit struck down an ERIP with an upper age limit in Jankovitz v. Des Moines Indep. Cmty Schools, 421 F.3d 649 (8th Cir. 2005). The plan provided health insurance premiums only until the age of 65, a one-time cash payment equal to approximately 30 percent of an employee's annual salary, and a lump sum payment based on the number of unused sick leave days accumulated as of the date of retirement. The court first held that the plan was discriminatory on its face, because the plan used an age limiting factor (age 65). Id. at 653. It further held that the plan was inconsistent with the purposes of ADEA (and thus did not fall within exemption) because "the amount of available early retirement benefits drops to zero upon the employee's attainment of the age of 65." Id. at 655.

IV. Conclusion

In enacting OWBPA, Congress sought to make clear that, in general, employee benefit plans were covered under ADEA. Most employee benefit plans were required either to provide equal benefits to older and younger workers or to demonstrate that it cost the same amount to provide fewer benefits to the older worker than the younger worker.

In OWBPA, Congress also chose to include an explicit exemption for ERIPS that would not be subject to the "equal cost equal benefit" standard applicable to most other employee benefit plans. As later applied by the courts, the ERIP exemption came to entail a two-stage process. If the ERIP was held not to violate the ADEA in the first place – for example, because the employer presented evidence that the plan design was based on a factor other than age and the plaintiff was unable to meet his or her burden of rebutting that evidence – the ERIP exemption would not come into play. If, however, a court concluded that a plaintiff had made out either a prima facie case of disparate treatment or of

disparate impact discrimination, the burden would then shift to the employer to demonstrate that the ERIP met the statutory exemption – i.e., that it was voluntary and consistent with the purposes of ADEA.

For an ERIP to be "consistent with the purposes" of the ADEA," it may not arbitrarily discriminate on the basis of age. This, of course, is also the test that courts apply to determine whether there has been disparate treatment based on age. Thus, it is perhaps not surprising that courts have reached similar conclusions using either disparate treatment (or disparate impact) analysis and ERIP exemption analysis.[19] Although the ultimate issues are similar (namely, that arbitrary age discrimination is most likely not "consistent" with the purposes of ADEA), if a court concludes that a prima facie case of discrimination has been established, the ERIP exemption does shift the burden to the employer to show that the challenged plan does not "arbitrarily discriminate" based on age.

[19] For example, the court in Solon, using a disparate treatment analysis, reached a similar conclusion to the court in Jankovitz, applying the ERIP exemption – namely that ERIPs with age-based windows or upper age limits were not valid under ADEA. Likewise, the courts in Auerbach and O'Brien arguably could have reached the same conclusions they reached by using a disparate treatment analysis, rather than using the ERIP exemption as they did. For example, in Auerbach, the defendant might have argued that the plan was based on years of service -- a non-age-related factor -- and the court might have found the plan valid under a disparate treatment analysis. Similarly, in O'Brien, after finding that the plaintiff had made out a prima facie case of discrimination, the court might have concluded that the defendant had not asserted a non-age-related justification for the plan.